

IN THE
Supreme Court of the United States

OCTOBER TERM, 1993

CENTRAL BANK OF DENVER, N.A.,
Petitioner,

v.

FIRST INTERSTATE BANK OF DENVER, N.A.,
and JACK K. NABER,
Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

**BRIEF AMICUS CURIAE OF THE ASSOCIATION
OF THE BAR OF THE CITY OF NEW YORK
IN SUPPORT OF RESPONDENTS**

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No. 92-854

In the SUPREME COURT OF THE UNITED STATES

October Term, 1993

Central Bank of Denver, N.A.,

Petitioner,

v.

First Interstate Bank of Denver, N.A., and Jack K. Naber,

Respondents.

On Writ of Certiorari to the
United States Court of Appeals
for the Tenth Circuit

BRIEF AMICUS CURIAE OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK IN SUPPORT OF RESPONDENTS

QUESTIONS PRESENTED

Amicus curiae will address the following questions:

1. Whether there is an implied private right of action for aiding and abetting violations of §10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5.
2. Whether recklessness is an appropriate standard upon which to predicate liability for aiding and abetting violations of §10(b) and Rule 10b-5.

INTEREST OF AMICUS CURIAE¹

Amicus Curiae The Association of the Bar of the City of New York (the "Association of the Bar") has a great interest in the questions presented in this case. The Association of the Bar is a professional organization of approximately 19,000 lawyers, located largely in New York City but including members located throughout the United States and in over forty other countries. Since its inception in 1870, the Association of the Bar has been dedicated to the preservation and advancement of the rule of law and the fair administration of justice. The scope of the Association of the Bar's concern with justice has not been limited to the confines of the City of New York but has extended throughout the nation.

As a bar group located in New York City, however, the Association of the Bar has a special interest in securities related issues. Since the Association of the Bar's founding, New York City has been the center of the nation's capital markets, and particularly its securities markets. The New York Stock Exchange and the American Stock Exchange are located in New York City, and most major broker-dealers are headquartered in and around New York City. A large percentage of the nation's lawyers who specialize in the practice of securities law are members of the Association of the Bar. Accordingly, the Association of the Bar has both special expertise and a special interest in the important issues of securities law that are presented in this case.

SUMMARY OF ARGUMENT

This case presents issues of the utmost importance for the protection of public investors from fraud in connection with publicly traded securities. Since 1939, in enforcement actions

¹ The parties have consented to the filing of this brief. Letters of consent are on file with the Clerk of the Court, pursuant to Rule 37.3 of the Rules of this Court.

by the Securities and Exchange Commission ("SEC"), and at least since 1966 in private civil actions under Section 10(b) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), aiding and abetting liability has been universally accepted by the lower courts. These courts have acknowledged that such liability is required to impose an appropriate standard of diligence and care on professionals such as attorneys and accountants, without whose assistance many financial frauds could not be perpetrated. Without aiding and abetting liability (*i.e.*, liability for intentional or reckless substantial assistance in securities fraud), it would be difficult or impossible to protect fully public investors by holding these professionals accountable for misdeeds which result in financial losses to such investors. Congress has long been aware of the law fashioned by the lower courts with respect to aiding and abetting liability and has repeatedly reflected its approval of the current legal standards.

Aiding and abetting liability is an integral element of the fabric of liability for fraud, not some recent addition to that fabric. Early in this century, great jurists routinely held that secondary violators could be held accountable for their substantial assistance to fraud.² Only last term, in *Musick, Peeler & Garrett v. Employers Ins. of Wausau*,³ one of the defendants against whom this Court recognized a right to contribution was a law firm that could only have been held liable under the federal securities laws as an aider and abetter. This Court described this law firm's aiding and abetting liability as "a wrong that courts have already deemed actionable under federal law."⁴ This language, and the Court's holding, reflect the degree to which aiding and abetting liability is universally assumed to be part of the remedy for fraud.

² See, e.g., *Ultramares Corp. v. Touche*, 255 N.Y. 170, 186 (1931) (Cardozo, J.).

³ 113 S. Ct. 2085, 2089 (1993).

⁴ *Id.* at 2088.

As an organization of attorneys, the Association of the Bar is, of course, sensitive to the issue of lawyers' exposure to large damage claims. But it is also concerned about creating proper incentives for professionals and other persons involved in securities markets and it is particularly concerned with maintaining the integrity of the Bar. A system that creates proper incentives for securities lawyers to exercise due care -- and avoid recklessness or intentional misconduct -- in securities transactions serves the interest of attorneys who are committed to performing their responsibilities in a professional and ethical manner, as well as the interest of their clients and those who rely on their clients. The Association of the Bar believes that securities lawyers, like accountants and other professionals, are fundamentally important to the process of offering and trading securities in impersonal complex markets. Public confidence in such professionals is essential to a sound securities market system. Enforcement of the securities laws against transgressor professionals thus both serves the public and the best interests of the Bar.

ARGUMENT

The federal securities laws were enacted in the wake of the economic chaos and monumental losses that resulted from the stock market crash of 1929. Speaking in 1933, Representative Sam Rayburn, a sponsor of the Securities Act of 1933, summarized the historical background against which that statute was enacted:

During the last 12 years, an era that is falsely designated as one of prosperity, [the] American people lost perhaps a hundred billion dollars through the purchase of stocks and bonds. This catastrophe [is] so colossal as to stagger the imagination.⁵

⁵ 77 Cong. Rec. H-2918 (May 5, 1933).

Congressional hearings during the 1930's exposed an extraordinary variety of frauds, market manipulations, and outright thefts of public funds that contributed to these "staggering" investor losses.⁶ Recent scandals on Wall Street and in the savings and loan industry emphasize the continuing need for vigorous enforcement of the anti-fraud remedies under the federal securities laws.

Investors in publicly traded securities often rely upon professionals in evaluating an investment. These professionals, such as attorneys, accountants, geologists, appraisers, engineers, and others, act as "gatekeepers," who assure the public investor of the financial integrity of the investment. Long before the adoption of the federal securities laws, courts recognized that reckless or intentional misconduct by such professionals was actionable by those who sustained damages in reliance upon the professional.⁷

In construing the anti-fraud provisions of the federal securities laws and their important remedial purposes, federal courts have necessarily applied ancient principles of aiding and abetting liability to hold responsible professionals whose conduct substantially assisted a primary wrongdoer, particularly where such professionals would otherwise escape liability. But for such liability, in many instances the innocent investor would be left, as a practical matter, with no remedy, or a wholly inadequate one. (See pp. 9-10 *infra*) Recognizing that elimination of aiding and abetting liability would seriously weaken the federal securities laws, Congress has repeatedly endorsed the lower courts' interpretation of the scope of Section 10(b) and assumed aiding and abetting liability. (See pp. 14-15 *infra*)

⁶ See J. Seligman, *The Transformation of Wall Street* ch. 1 (1982).

⁷ See, e.g., *Ultramares Corp. v. Touche*, 255 N.Y. 170 (1931).

If this Court eliminates aiding and abetting principles of liability, wrongdoing professionals would escape liability in many instances where they are now legally responsible. Such a result would hurt investor confidence in honest and diligent professionals, as well as in the securities markets, and thwart the repeatedly expressed will of Congress.

The long recognized standard of recklessness should be maintained for aiding and abetting liability, subject to the equally well established requirement that the only aiders and abettors who should be liable are those who have rendered substantial assistance to primary wrongdoers. Maintenance of the recklessness standard is essential to keep the remedy viable. The additional requirement of substantial assistance keeps the remedy balanced and fair. (See p. 19 *infra*)

I. THIS COURT SHOULD CONTINUE TO RECOGNIZE AN IMPLIED CAUSE OF ACTION FOR AIDING AND ABETTING LIABILITY

A. Aiding and Abetting Liability Is Consistent with the Remedial Purposes of the Federal Securities Laws and Essential to Their Proper Functioning

1. The Role of Aiders and Abettors in the Commission of Securities Fraud

This Court has repeatedly interpreted Section 10(b) flexibly and broadly.⁸ Aiding and abetting liability has been recognized

⁸ As this Court observed in *Superintendent of Ins. of the State of New York v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971), "[s]ince practices 'constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means . . . we do not read §10(b) . . . narrowly [I]t is not 'limited to preserving the integrity of the securities markets' . . . though that purpose is included. Section 10(b) must be read flexibly, not technically and restrictively."

as necessary. Without aiding and abetting liability, many of the experts, whose technical expertise plays a crucial role in the securities markets, and on whose credibility both buyers and sellers of securities depend, would be essentially immune from liability. As Judge Henry Friendly observed with characteristic insight, in upholding the criminal conviction of a lawyer who violated Section 17(a) of the Securities Act of 1933 (a section which closely parallels the language of Rule 10b-5 under the Exchange Act):

[i]n our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar. . . . Congress . . . could not have intended that men holding themselves out as members of these ancient professions should be able to escape . . . liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or have represented a knowledge they knew they did not possess.⁹

The essential function of accountants in protecting the public from fraud has been explicitly recognized by this Court, which has observed that "[b]y certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client."¹⁰ As a consequence of "[t]his 'public watchdog' function . . . the accountant [must]

⁹ *United States v. Benjamin*, 328 F.2d 854, 863 (2d Cir.), *cert. denied*, 377 U.S. 953 (1964). That Judge Friendly was upholding a criminal conviction only emphasizes the argument in this brief. If accountants and lawyers can go to jail for reckless conduct which results in financial loss to innocent investors, then surely public policy requires that they compensate those investors for the damage sustained as a result of such conduct.

¹⁰ *United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 & n. 15 (1984) (emphasis in the original).

maintain total independence from the client at all times and requires complete fidelity to the public trust."¹¹ This "public watchdog" role of accountants "assures that the integrity of the securities markets will be preserved. . . . The SEC requires the filing of audited financial statements in order to obviate the fear of loss from reliance on inaccurate information, thereby encouraging public investment in the Nation's industries. It is therefore not enough that financial statements be accurate; the public must also perceive them as being accurate. Public faith in the reliability of a corporation's financial statements depends upon the public perception of the outside auditor as an independent professional."¹²

With respect to attorneys, the SEC has accurately explained the special role of the securities attorney because of public faith in their integrity. We agree with the SEC's recognition of "the peculiarly strategic and especially central place of the private practicing lawyer in the investment process and in the enforcement of the body of federal law aimed at keeping that process fair."¹³ "[T]he task of enforcing the securities laws rests in overwhelming measure on the bar's shoulders."¹⁴ This is because of the unique role of the securities lawyer in the preparation of documents that are required to market securities to the public: "Very little of a securities lawyer's work is adversary in character. He doesn't work in courtrooms where the pressure of vigilant adversaries and alert judges checks him. He works in his office where he prepares prospectuses, proxy statements, opinions of counsel, and other documents that we [at the SEC], our staff, the financial community and the investing public must

¹¹ *Id.*

¹² *Id.*

¹³ *In re Emanuel Fields*, 45 S.E.C. 262, 266 n.20 (1973), *aff'd without opinion*, 495 F.2d 1075 (D.C. Cir. 1974).

¹⁴ *Id.*

take on faith. This is a field where unscrupulous lawyers can inflict irreparable harm on those who rely on the disclosure documents that they produce."¹⁵

Similar gatekeeping functions are performed by other experts, such as geologists, appraisers, engineers, actuaries, and rating agencies. The integrity and reputations of these professionals are relied upon by the public to ensure that material representations made in connection with securities transactions are accurate and not misleading. The technical expertise of those professionals, however, is frequently an essential ingredient in the commission of securities fraud.

2. The Need for Aiding and Abetting Liability

Section 10(b) has long been the most effective means for private plaintiffs to obtain relief for securities fraud. A plaintiff may not be able to bring a primary liability claim under Section 10(b) against the accountants, lawyers, and other professionals who knowingly or recklessly assist a fraud. These professionals often fail to participate directly in the sale of the securities and most often lack any fiduciary relationship with the plaintiff. Moreover, the control person liability does not usually apply.¹⁶ Seldom can a plaintiff claim that the accountants, lawyers, or other professionals actually controlled the transaction. Nor can a plaintiff often sue these defendants under Section 12 of the Securities Act, which applies to sellers, because the accountants, lawyers, and other professionals typically fail to participate directly in the sale of securities.¹⁷

The aiding and abetting theory permits Section 10(b) to be applied to fraudulent conduct by defendants who were

¹⁵ *Id.*

¹⁶ 15 U.S.C. § 78t(a); 15 U.S.C. § 77o.

¹⁷ *Pinter v. Dahl*, 486 U.S. 622 (1988).

instrumental in causing the fraud, even though they neither sold the securities nor had any contact with the plaintiff.

B. Principles of Statutory Construction Support an Implied Private Right of Action for Aiding and Abetting Liability

1. Relevant Principles of Statutory Construction

In recent years, this Court has frequently confronted the question of whether to find an implied private right of action under a federal statute. The focus of the Court's inquiry in these cases has been on the intent of the Congress. As this Court noted when it found an implied private right of action for violations of the Commodities Exchange Act, this inquiry is different when Congress legislates in an area in which courts have already found an implied private right of action:

[w]hen Congress enacts new legislation, the question is whether Congress intended to create a private remedy as a supplement to the express enforcement provisions of the statute. When Congress acts in a statutory context in which an implied private remedy has already been recognized by the courts, however, the inquiry logically is different. Congress need not have intended to create a new remedy, since one already existed; *the question is whether Congress intended to preserve the pre-existing remedy.*¹⁸

This Court applied similar reasoning to find an implied private right of action under Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder. This Court relied principally upon Congressional action in amending the Exchange Act in

¹⁸ *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 378-79 (1982)(emphasis added).

1975 with an awareness that numerous lower courts had found an implied private right of action under Section 10(b) and Rule 10b-5:

when Congress comprehensively revised the securities laws in 1975, a consistent line of judicial decisions had permitted plaintiffs to sue under § 10(b) regardless of the availability of express remedies. . . . When Congress acted, federal courts had consistently and routinely permitted a plaintiff to proceed under § 10(b) even where express remedies under § 11 or other provisions were available. In light of this well-established judicial interpretation, Congress' decision to leave § 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action.¹⁹

Thus, the test for determining whether Congress intended to recognize an implied private right of action for aiding and abetting liability depends on whether Congress amended the Exchange Act after the lower courts had consistently recognized such an implied private right of action and left that implied right of action untouched. Here, that test has clearly been met.

2. Aiding and Abetting Liability Has Long Been Accepted by the Lower Courts and Congress Has Acted in this Context

The doctrine of aiding and abetting liability was first recognized in a civil action under the federal securities laws in a case brought by the SEC.²⁰ In that case, where the SEC alleged violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), the anti-fraud prohibition under that statute,

¹⁹ *Herman & MacLean v. Huddleston*, 459 U.S. 375, 384-86 (1983).

²⁰ *SEC v. Timetrust, Inc.*, 28 F. Supp. 34 (N.D. Cal. 1939).

the court accepted the doctrine of aiding and abetting by analogy to the criminal law concept.²¹ The SEC also applied the doctrine of aiding and abetting liability in its administrative proceedings, before the Exchange Act was amended to create express liability for aiding and abetting in these proceedings.²²

Liability premised on aiding and abetting was first recognized in a private civil action under the federal securities laws in 1966.²³ The court in that case relied upon the formulation of aiding and abetting liability set forth in the Restatement of Torts:

For harm resulting to a third person from the tortious conduct of another, a person is subject to liability if he . . . knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself. . . .²⁴

²¹ "Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal." 18 U.S.C. § 2(a).

²² See, e.g., *Burley & Co.*, 23 S.E.C. 461, 463-64, 467-68 & n.11 (1946).

²³ *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673, 676-77 (N.D. Ind. 1966), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

²⁴ *Restatement of Torts* § 876(b) (1939). The *Restatement (Second) of Torts* contains the same language, noting the numerous Rule 10b-5 cases that have invoked it. See § 876(b) (1979) and App. § 876 (1982 & Supp. 1988).

The doctrine of aiding and abetting liability was recognized in tort law long before the First Restatement. See T. Cooley, *A Treatise of the Law of Torts* 244 (3d ed. 1906) ("All who actively participate in any manner in the commission of a tort, or who command, direct, advise, encourage, aid or abet its commission are jointly and severally liable therefor.").

Following *Brennan*, every federal court that has considered the question has found aiding and abetting liability in private actions under the federal securities laws.²⁵

²⁵ *First Circuit: Cleary v. Perfectune, Inc.*, 700 F.2d 774 (1st Cir. 1983).

Second Circuit: IIT v. Cornfeld, 619 F.2d 909, 922 (2d Cir. 1980); *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47-48 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978); *Hirsch v. du Pont*, 553 F.2d 750, 759 (2d Cir. 1977).

Third Circuit: Healey v. Catalyst Recovery of Pennsylvania, Inc., 616 F.2d 641, 651 (3d Cir. 1980); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 799 (3d Cir.), *cert. denied*, 439 U.S. 930 (1978); *Gould v. American-Hawaiian S.S. Co.*, 535 F.2d 761, 779 (3d Cir. 1976); *Landy v. FDIC*, 486 F.2d 139, 163 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

Fourth Circuit: Schatz v. Rosenberg, 943 F.2d 485 (4th Cir. 1991), *cert. denied*, 112 S.Ct. 1475 (1992).

Fifth Circuit: Woodward v. Metro Bank of Dallas, 522 F.2d 84, 94-95 (5th Cir. 1975).

Sixth Circuit: SEC v. Washington County Util. Dist., 676 F.2d 218, 223-27 (6th Cir. 1982); *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975).

Seventh Circuit: Hochfelder v. Midwest Stock Exch., 503 F.2d 364, 374 (7th Cir.), *cert. denied*, 419 U.S. 875 (1974).

Eighth Circuit: Stokes v. Lokken, 644 F.2d 779, 782-83 (8th Cir. 1981).

Ninth Circuit: Strong v. France, 474 F.2d 747, 752 (9th Cir. 1973).

Tenth Circuit: Kerbs v. Fall River Indus., Inc., 502 F.2d 731, 740 (10th Cir. 1974).

Eleventh Circuit: Woods v. Barnett Bank, 765 F.2d 1004 (11th Cir. 1985).

District of Columbia: The District of Columbia has not considered the question in private actions, but has found aiding and abetting liability in actions brought by the SEC. See *SEC v. Falstaff Brewing Corp.*, 629 F.2d 62, 72 (D.C. Cir.), *cert. denied*, 449 U.S. 1012 (1980); *Investors Research Corp. v. SEC*, 628 F.2d 168, 177 (D.C. Cir.), *cert. denied*, 449 U.S. 919 (1980).

That there is civil liability for aiding and abetting a violation of Rule 10b-5 was so widely acknowledged that the petitioners themselves failed to seek review of that issue. In addition this Court itself has implicitly assumed the existence of such liability. In *Musick, Peeler*, this Court held that there was a right of contribution against attorneys and accountants "based on the 10b-5 action central to the complaint."²⁶ The only theory on which liability under Rule 10b-5 could be asserted against nonsettling lawyers and accountants would be aiding and abetting. It is reasonable to assume that this Court would not have decided a wholly hypothetical issue of contribution if there were no underlying basis for asserting liability against the non-settling parties.

This pattern of universal recognition of an implied private right of action for aiding and abetting liability parallels exactly the pattern that persuaded this Court in *Huddleston* to recognize an implied private right of action for violations of Section 10(b). As this Court noted in *Huddleston*, "[i]n 1975 Congress enacted the 'most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act in 1934.' . . . Congress' decision to leave § 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action."²⁷

Thus, it is clear that under the test this Court applied in *Curran* and *Huddleston*, Congressional intent supports the recognition of an implied private right of action against those who aided and abetted a securities fraud in violation of Rule 10b-5.

3. Congress Itself Has Recognized the Propriety of Aiding and Abetting Liability

In the case of aiding and abetting liability, the case for Congressional recognition of this remedy is even stronger than in

²⁶ *Musick*, 113 S. Ct. at 2086-87.

²⁷ *Huddleston*, 459 U.S. at 385-86.

Huddleston itself. Twice Congress has expressly acknowledged and approved the existence of this remedy. First, in 1983, a Congressional report on the Insider Trading Sanctions Act of 1984 endorsed "the judicial application of aiding and abetting liability to achieve the remedial purposes of the securities laws."²⁸ Similarly, in a 1988 report on the Insider Trading and Securities Fraud Enforcement Act of 1988, Congress noted that, although the express private right of action created by that statute precludes suits based on the theory of *respondent superior*, it "does not affect the availability of any other theories of liability, such as aiding and abetting . . . in appropriate circumstances."²⁹

Only last term, this Court observed that recent Congressional action in adopting the Insider Trading and Securities Fraud Enforcement Act of 1988 and the legislation respecting limitations periods for Rule 10b-5 actions reflects "an acknowledgement of the 10b-5 action without any further expression of legislative intent to define it."³⁰ This Court also noted that "the caution in" Congress's limitation on the retroactive effect of the *Lampf*³¹ decision "is instructive."³² Essentially, Congress has sent a message that it approves of the current state of the law with respect to Section 10(b) liability. Fidelity to the current standards of liability is thus consistent with Congressional intent.

²⁸ H.R. Rep. 355, 98th Cong., 2d Sess. 10 (1983)(citing *SEC v. Coven*, 581 F.2d 1020, 1028 (2d Cir. 1978), *cert. denied*, 440 U.S. 950 (1979) and *Rolf v. Bythe, Eastman Dillon & Co.*, 570 F.2d 38 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978)).

²⁹ H.R. Rep. No. 910, 100th Cong., 2d Sess. 27-28 n. 23.

³⁰ *Musick*, 113 S. Ct. at 2089.

³¹ *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773 (1991).

³² *Musick*, 113 S. Ct. at 2089.

II. THE RECKLESSNESS STANDARD IS APPROPRIATE FOR AIDING AND ABETTING LIABILITY

A. Background: The Meaning of Recklessness

Most courts have applied the following definition of recklessness in the context of aiding and abetting liability:

[R]eckless conduct may be defined as a highly unreasonable [act or] omission, involving not merely simple, or even inexcusable, negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.³³

This definition is consistent with the definitions of reckless conduct in the *Restatement (Second) of Torts*,³⁴ and the Model Penal Code.³⁵ It is also consistent with standards applied for

³³ *Franke v. Midwestern Oklahoma Dev. Auth.*, 428 F. Supp. 719, 725 (W.D. Okla. 1976), *vacated on other grounds*, 619 F.2d 856 (10th Cir. 1980). See, e.g., *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033 (7th Cir.), *cert. denied sub nom.*, *Meers v. Sundstrand Corp.*, 434 U.S. 875 (1977)(quoting *Franke*).

³⁴ § 526: "A misrepresentation is fraudulent if the maker (a) knows or believes that the matter is not as he represents it to be, (b) does not have the confidence in the accuracy of his representation that he states or implies, or (c) knows that he does not have the basis for his representation that he states or implies."

³⁵ § 2.02(c): "A person acts recklessly with respect to a material element of an offense when he consciously disregards a substantial and unjustifiable risk that the material element exists or will result from his conduct. The risk must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, its disregard involves a gross deviation from the standard of conduct that a law-abiding person would observe in the actor's situation."

generations in common-law actions for fraud. As a court observed almost sixty years ago in holding an accountant liable for fraud:

[a] representation certified as true to the knowledge of the accountants when knowledge there is none, a reckless misstatement, or an opinion based on grounds so flimsy as to lead to the conclusion that there was no genuine belief in its truth, are all sufficient upon which to base liability. A refusal to see the obvious, a failure to investigate the doubtful, if sufficiently gross, may furnish evidence leading to an inference of fraud so as to impose liability for losses suffered by those who rely on the balance sheet. In other words, heedlessness and reckless disregard of consequence may take the place of deliberate intention.³⁶

B. The Current Recklessness Standard for Aiding and Abetting Liability Is Consistent with the Remedial Purposes of the Federal Securities Laws

Application of a recklessness standard for aiding and abetting liability serves the broad remedial purposes of the federal securities laws. As explained above, aiding and abetting liability is the principal theory available to hold attorneys, accountants and other professionals accountable for wrongdoing under the federal securities laws. These professionals, the gatekeepers of the securities markets, can, by fulfilling the responsibilities they

³⁶ *State Street Trust Co. v. Ernst*, 278 N.Y. 104, 112 (1938). See also *Ultramares Corp. v. Touche*, 255 N.Y. 170, 186 (1931) (Cardozo, J.) ("Even an opinion, especially an opinion by an expert, may be found to be fraudulent if the grounds supporting it are so flimsy as to lead to the conclusion that there was no genuine belief back of it.")

assumed protect the public from fraud, while by their indifference to such responsibilities they can inflict enormous pecuniary loss on the public.

The recklessness standard of *scienter* creates the right incentives for these professionals. When they become aware of warnings of possible fraud, the recklessness standard requires them to inquire further and to satisfy themselves that a fraud is not occurring. On the other hand, they are not exposed to liability for mere negligence; such a standard would be unfair and impose too great a risk on professionals. This is essentially the formulation enumerated by Judge Cardozo more than sixty years ago.³⁷ It was sound then and it remains sound now.

A standard that requires proof of actual knowledge rather than recklessness would disrupt this proper balance of incentives. For example, if an attorney could be held liable only if he or she had actual knowledge of the fraud, a lawyer would have every incentive to merely ignore a red flag suggesting fraud. To paraphrase Judge Friendly, shutting his eyes -- deliberately ignoring his professional responsibility -- would actually shield him from exposure to financial losses because his conduct was only reckless. Thus, requiring proof of intentional misconduct would create an incentive for attorneys, accountants, and other professionals to play a passive role in securities transactions. Such a standard would not only lead to less trustworthy securities markets, but would also frustrate the purposes of the federal securities laws and undermine the protection otherwise afforded by aiding and abetting liability.

Perhaps yet another reason why judges as wise as Cardozo and Friendly equated recklessness with intentional conduct in the case of fraud by a professional is the difficulty in proving intentional conduct in such circumstances. Rarely will there be a confession or admission by another party that the professional

³⁷ *Ultramares Corp. v. Touche*, 255 N.Y. 170.

was aware of the fraud. Indeed, questions of privilege could heavily burden inquiries into the professional's relevant knowledge. A recklessness standard provides an objective basis for determining that in fact the professional knew of the fraud or, in an extreme violation of professional standards, chose not to know.

C. The Substantial Assistance Requirement for Aiding and Abetting Liability Affords a Proper Balance When Coupled with the Recklessness Standard

In arguing for a relaxed standard of conduct, the petitioners and the *amici* supporting the petitioners express concern that a recklessness standard would impose greater liability on those who had a "remote link to a securities transaction than against a principal participant...."³⁸ This argument ignores the requirement that an aider and abettor render substantial assistance to the principal. The contours and definition of the substantial assistance requirement have been shaped by innumerable decisions in lower federal courts. While the issue is not now before the Court, the substantial assistance requirement protects professionals whose connection with the transaction is remote and shields them from the parade of imaginary horrors conjured up by petitioner and *amici* supporting its position.³⁹

³⁸ *Amicus* Brief of the Securities Industry Association at p. 28.

³⁹ In addition, under *Musick*, 113 S. Ct. 2085, a party with such secondary liability has the right to seek contribution from primary wrongdoers.

SUMMARY AND CONCLUSION

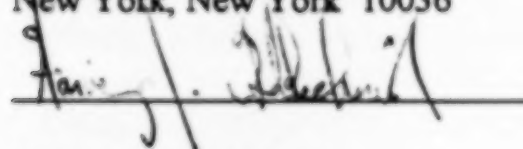
The preservation of the civil remedy for persons damaged by those who aid and abet a securities fraud is essential to the effectiveness of the federal securities laws and fully consistent with the public policies of the statute as endorsed by this Court. Congress has acknowledged the importance of the remedy. Recklessness is the only appropriate scienter requirement in such a case. Accordingly, the decision below should be affirmed.

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New York, New York

Respectfully submitted,

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